

Euro wrap-up

Overview

- Despite an improvement in Italian business and consumer confidence and pickup in Spanish retail sales, Bunds followed USTs higher.
- Gilts also made gains on a quiet day for UK economic news.
- Friday will bring flash May inflation estimates from Germany, Italy and Spain and euro area bank lending figures for April.

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Daily bond market movements

| Bond | Yield | Change |
|---------------|-------|--------|
| BKO 1.7 06/27 | 1.769 | -0.024 |
| OBL 2.4 04/30 | 2.077 | -0.028 |
| DBR 2½ 02/35 | 2.517 | -0.035 |
| UKT 3¾ 03/27 | 4.009 | -0.057 |
| UKT 4¾ 03/30 | 4.146 | -0.055 |
| UKT 4½ 03/35 | 4.666 | -0.059 |

*Change from close as at 4:00pm BST.

Source: Bloomberg

Euro area

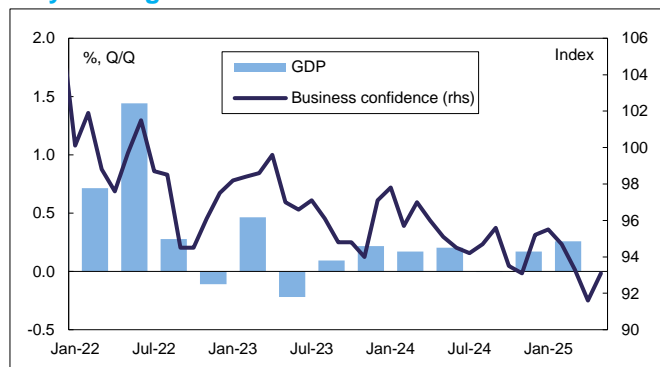
Italian business and consumer surveys point to a stabilisation in conditions in May

While the Italian economy fared relatively well in Q1, with GDP growth the strongest in two years (0.3%Q/Q), surveys predictably pointed to a deterioration in conditions at the start of Q2 in the face of US trade uncertainties. Indeed, ISTAT's consumer confidence index dropped to an 18-month low, while its business confidence index fell to the lowest since January 2015 (when excluding Covid lockdown periods). As expected, today's Italian advance goods trade figures flagged a tariff-related slump in exports at the start of Q2, with shipments to non-EU countries down 7½%M/M in April following growth of 4.8%Q/Q in Q1. But the latest ISTAT business and consumer surveys signalled some stabilisation in conditions in May and were arguably consistent with an economy moving sideways rather than contracting this quarter. In particular, the headline business sentiment indicator rose 1.5pts in May to 93.1, largely reversing the drop in April. With order books judged to be no smaller than in Q1 and perhaps reflecting minimal front-loading of production last quarter, the manufacturing sentiment index rose to a three-month high in May and was trending less than ½pt below the Q1 average. Services firms were also more upbeat about activity in May and expected demand to pickup over the coming three months too. Retailers were more sanguine than in April as consumers suggested that they were more willing to purchase durable goods than at any time in the past seven months. But the headline services and retail sector indices were nevertheless still trending almost 4pts and 2½pts below the Q1 average, suggesting a slowdown in activity this quarter. Despite rising to a three-month high, the headline consumer confidence index was also averaging more than 2½pts below the Q1 level. And with construction sentiment slipping to a five-month low, as order books were expected to shrink further over the coming three months, the boost to economic output from that sector in Q1 (2½%Q/Q) seems unlikely to be repeated this quarter or next. Overall, we expect the Italian economy to be flat this quarter before returning to modest growth in Q3.

Spanish retail sales rebound in April to suggest another quarter of firm GDP growth in Q2

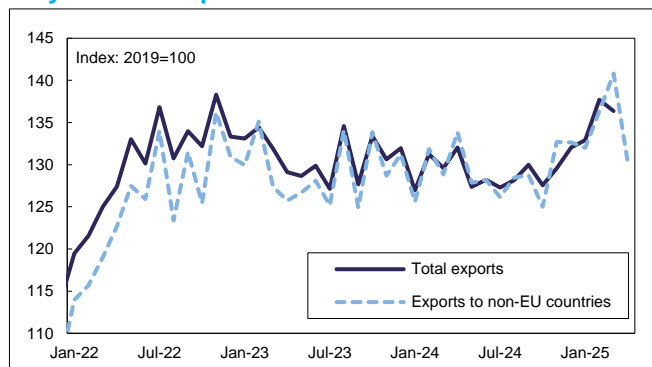
Despite representing another quarter of strong economic growth, the pace of Spain's expansion in Q1 (0.6%Q/Q) was nevertheless the softest in seven quarters. This in part reflected a slowdown in household consumption to a five-quarter low (down ½ppt to 0.4%Q/Q). Admittedly, this still added some 0.2ppt to GDP growth. And today's retail sales figures for April suggested that consumer spending should remain supportive of economic growth in Q2. In particular, having moved sideways in March, retail sales rose 0.7%M/M (4.0%Y/Y) in April, with food sales up for a fourth month out of the past five and non-food sales more than reversing the dip in March. This left sales some 1.1% above the Q1 average, after growth of 0.4%Q/Q in Q1. And with the Commission's economic sentiment index trending in April and May a touch firmer than in Q1 and still comfortably above the long-run average, we expect continued Spanish outperformance of the larger member states this quarter, with growth of 0.5%Q/Q or more.

Italy: GDP growth & ISTAT business sentiment



Source: Macrobond, ISTAT and Daiwa Capital Markets Europe Ltd.

Italy: Goods exports



Source: Macrobond, ISTAT and Daiwa Capital Markets Europe Ltd.

The day ahead in the euro area

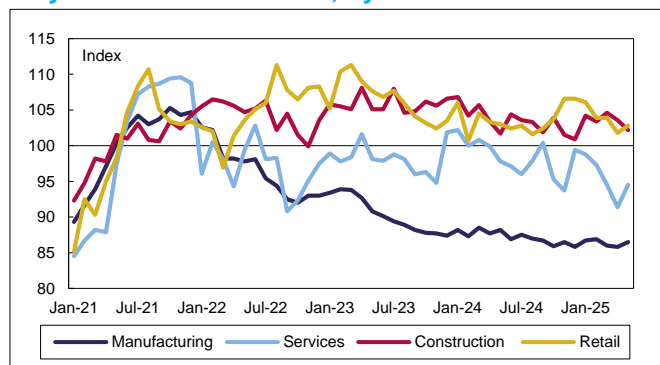
May's preliminary inflation data from Germany, Italy and Spain will mark Friday's main euro area event. Consistent with [Tuesday's French estimates](#), we expect those to flag renewed moderation in the services component as the effects of last month's Easter-related increases fall away. That should weigh on core inflation measures across the member states, while further softening in the energy components is also likely to lend support to broader disinflation. So, we would expect to see the headline HICP rates in Germany and Spain, both respectively 2.2%Y/Y in April, to move closer to the ECB's inflation target. Indeed, such a reading would reaffirm our forecast for the aggregate euro area HICP inflation rate – due 3 June – to return to 2.0%Y/Y while also cementing the likelihood of another round of policy easing at next week's Governing Council meeting.

Elsewhere, policymakers will take account of April's monetary data for signs of whether tighter financial conditions and heightened trade uncertainty adversely impacted bank lending to households and businesses. In Germany, the knock-on effects of those shocks to households' savings preferences and mounting fears around job security could serve as headwinds to April's retail sales growth. Granted, today's Spanish retail sales figures suggest that consumers were largely undeterred by those shocks. But that may also have been related to the timing of Easter this year, which could also serve as a tailwind to April's German figures. Finally, the end of the week will also bring final estimates of Italian GDP growth in Q1. Preliminary estimates flagged growth of 0.3%Q/Q in Q1, the fastest since Q124. Despite signs of frontloading exports to the US in March, the breakdown by expenditure components is expected to reveal that an increase in imports left net trade subtracting from growth.

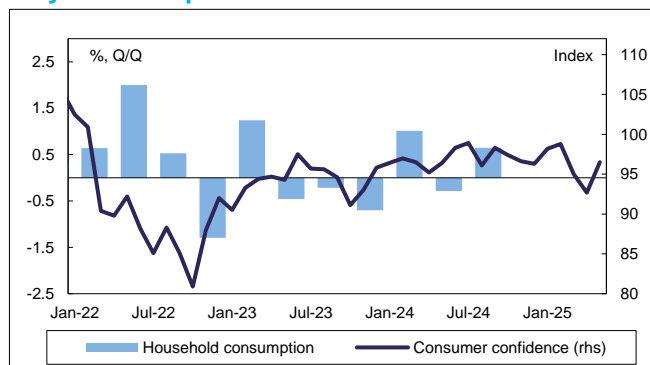
The day ahead in the UK

It should be another quiet day for UK economic news, with just May's round of the Lloyds' business survey due at the end of the week.

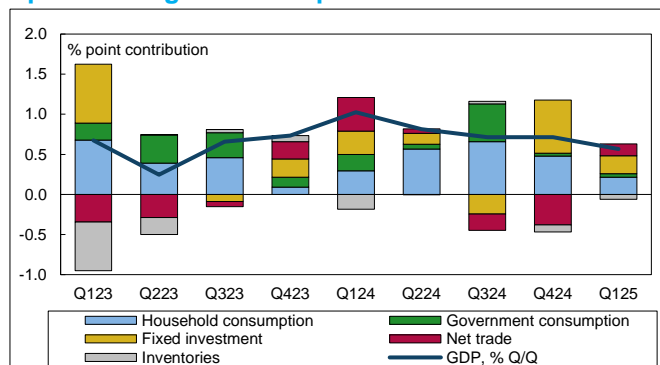
Italy: Business sentiment, by subsector



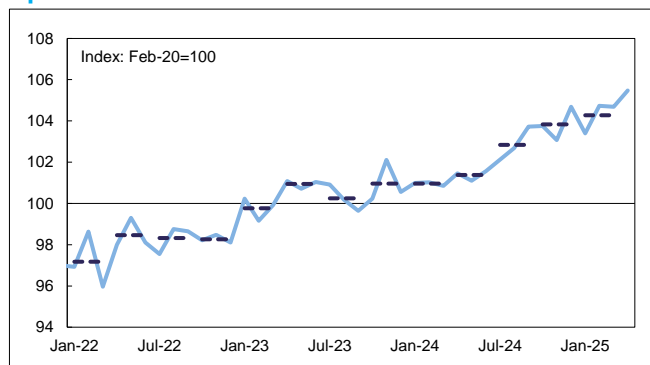
Italy: Consumption & consumer sentiment



Spain: GDP growth & expenditure contributions






Spain: Retail sales*







European calendar

Today's results

Economic data

| Country | Release | Period | Actual | Market consensus/ <i>Daiwa forecast</i> | Previous | Revised |
|---------|---|--------|--------------------|--|-------------|-------------|
| Italy |  ISTAT consumer confidence indicator | May | 96.5 | 93.0 | 92.7 | - |
| |  ISTAT business (manufacturing) confidence indicator | May | 93.1 (86.5) | - (86.2) | 91.5 (85.7) | 91.6 (85.8) |
| Spain |  Retail sales Y/Y% | Apr | 4.0 | - | 3.6 | 3.8 |









Auctions

| Country | Auction |
|---------|--|
| Italy |  sold €3.25bn of 2.95% 2030 bonds at an average yield of 2.73% |
| |  sold €3.5bn of 2034 floating bonds at an average yield of 3.28% |
| |  sold €3.25bn of 3.6% 2035 bonds at an average yield of 3.57% |
| UK |  sold £1.25bn of 0.125% 2031 inflation-linked bonds at an average yield of 0.827% |

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

| Country | BST | Release | Period | Market consensus/ <i>Daiwa forecast</i> | Previous |
|-----------|---|--|--------|--|-----------|
| Euro area |  09.00 | M3 money supply Y/Y% | Apr | 3.7 | 3.6 |
| Germany |  07.00 | Retail sales M/M% (Y/Y%) | Apr | 0.2 (-1.8) | 0.4 (0.9) |
| |  13.00 | Preliminary HICP (CPI) Y/Y% | May | 2.0 (2.1) | 2.2 (2.1) |
| Italy |  09.00 | GDP – final estimate Q/Q% (Y/Y%) | Q1 | <u>0.3 (0.6)</u> | 0.2 (0.6) |
| |  10.00 | Preliminary HICP (CPI) Y/Y% | May | 1.9 (1.7) | 2.0 (1.9) |
| |  11.00 | PPI Y/Y% | Apr | - | 5.4 |
| Spain |  08.00 | Preliminary HICP (CPI) Y/Y% | May | 2.0 (2.1) | 2.2 (2.2) |
| UK |  00.01 | Lloyds business barometer (own price expectations) | May | - | 39 (68) |

Auctions and events

- Nothing scheduled -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

<https://www.uk.daiwacm.com/ficc-research/recent-blogs>

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